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ALERT

Democrats Introduce Carbon Border Adjustment Legislation

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On July 19, 2021, Senator Chris Coons (D-DE) and Representative Scott Peters (D-CA) introduced legislation that would create a border tax on carbon-intensive imports. The carbon border adjustment proposal is part of the "Fair, Affordable, Innovative, and Resilient Transition and Competition Act" (FAIR Transition and Competition Act), which is expected to be attached to the larger $3.5 trillion spending package proposed by Democrats. The bill text and a one-page summary are available online.

Under this proposal, a carbon fee would be applied to imports at the U.S. border starting in 2024. Imports of petroleum, natural gas, coal, and other products with carbon-intensive production processes, such as aluminum, steel, iron, and cement, would be covered. It is estimated that 12% of U.S. imports would be subject to the tax. Additional sectors may be covered when it is determined there is reliable data concerning the carbon emissions content of products in those sectors. Exempted from the proposed border adjustment are imports from "least developed countries" and any country that does not impose a similar carbon border tax and is found to enforce laws and regulations designed to limit or reduce carbon emissions that are "at least as ambitious" as U.S. federal laws and regulations.[1] Notably, there is no partial exemption for countries that maintain carbon emissions policies that are not as ambitious as U.S. federal laws, meaning that imports from countries that fall short of U.S. policies would be taxed at the full amount. As explained below, however, individual importers may petition the U.S. government to revise the carbon emissions content calculated for their products.

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A carbon border adjustment is a fee on imports based on the carbon emissions incurred in the production of those goods. In effect, it is a carbon tax on foreign products entering the U.S. market. This levels the playing field between domestically produced goods and foreign imports based on the carbon costs of manufacturing that same merchandise in the United States. A border adjustment also combats carbon leakage. When countries tax and regulate carbon emissions at different levels, production will shift away from countries with more stringent climate policies and towards countries with less restrictive climate measures. This is especially so in carbon-intensive industries, such as aluminum and steel. The ensuing race-to-the-bottom effect hurts countries with strong climate policies and disadvantages carbon efficient producers, including many U.S. manufacturers.

The FAIR Transition and Competition Act calls for the federal government to calculate the "domestic environmental cost" of production in each of the covered sectors in complying with federal, state, or local laws and regulations that are "designed to limit or reduce greenhouse gas emissions." Such costs include those incurred in complying with the Clean Air Act, emissions standards for passenger cars and light trucks, and any other state, regional, or local program that imposes a cap-and-trade system or tax on carbon emissions. The legislation is both forward- and backward-looking in that it covers policies already enacted as well as any carbon emissions laws or regulations implemented in the future. The amount of the border tax is based on multiplying the carbon emission content of the imported product by the domestic environmental cost in the U.S. sector for that product. In short, the tax approximates the domestic carbon costs that foreign manufacturers would have borne had they produced their goods in the United States.

Where reliable data is not available to calculate the emissions content of an imported product, an emissions benchmark will be used based on the emissions data of the highest emitting sites within a company's relevant sector in the United States. The proposal allows for importers to petition the U.S. government and challenge the carbon emissions found to be incurred in the production of their goods.

Revenue collected from the proposed tax will be used to fund the administration of the carbon border adjustment program. Fifty percent of the remaining revenue will be provided as grants to states to support climate adaption policies, transition assistance, and communities facing the most severe impacts of climate change and historic pollution. The other 50% of the remaining revenue will go towards supporting research and development concerning the reduction or elimination of carbon emissions.

While the carbon border adjustment mechanism would be applied under U.S. law, it could be subject to challenge at the World Trade Organization (WTO). Under WTO trade rules, countries are allowed to tax imports at the border to adjust for certain domestic taxes. The FAIR Transition and Competition Act is unique in that the border adjustment is being applied without an observable domestic price of carbon emissions. Unlike other countries that identify the cost of carbon through carbon emissions trading systems, taxes, and other policies, the United States does not have a price for the cost of carbon at the national level. Rather, the proposed border measure would account largely for regulatory compliance costs associated with carbon-intensive production. This design may increase the likelihood that the carbon border adjustment could be challenged at the WTO. If successful, however, this legislative model could be expanded to impose border fees to adjust for other types of domestic environmental costs.

Regardless, it is very possible that any U.S. carbon border adjustment policy will be challenged at the WTO. In all likelihood, the United States would have to justify this type of border adjustment under one of the narrow environmental exceptions provided in Article XX of the General Agreement on Tariffs and Trade (GATT). Doing so would require that the measure be applied in an even-handed manner. As a result, the adjustment must be designed, implemented, and enforced in a way that does not discriminate among WTO member countries or favor domestic products over foreign imports. Traditionally, this has been high standard, and it may be difficult to meet. However, there may be strong interest among WTO members in allowing countries to develop climate-focused trade policies that are applied in a non-discriminatory manner.

For more information, please contact any of the attorneys listed.

[1] The proposal exempts "any country included on the list of Least Developed Countries on the most recent Development Assistance Committee List of Official Development Assistance Recipients published by the Organization for Economic Co-operation and Development."